

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 16374
[Redacted])	
)	DECISION
Petitioners.)	
_____)	

On January 25, 2002, the Idaho State Tax Commission (Tax Commission) issued a Notice of Deficiency Determination to [Redacted] (petitioners), proposing additional income tax and interest for the taxable year 1999 in the total amount of \$15,710. The petitioners filed a timely protest and petition for redetermination. The Tax Commission, having reviewed the file, hereby issues its decision.

The Tax Commission's Income Tax Audit Bureau (hereafter "ITA") issued to the petitioners a Notice of Deficiency Determination in which ITA disallowed a \$165,848 capital gain deduction claimed by the petitioners on their 1999 Idaho individual income tax return. ITA disallowed the capital gain deduction since the property generating the capital gain was not "qualified property" as defined in Idaho Code section 63-3022H.

The petitioners calculated the \$165,848 Idaho capital gain deduction as follows:

Description	Gain
Gain on sale of Florida real property, unit 58	\$ 38,132.38
Gain on sale of Florida real property, unit 60	\$ 38,001.18
Gain on sale of Florida real property, unit 98	\$ 58,973.88
Gain on sale of Florida real property, unit 124	\$ 61,022.73
Gain on sale of Florida real property, unit 129	\$ 58,925.85
Gain on goodwill (petitioners' Idaho gift shop)	\$ 21,357.12
Total	\$ 276,413.14
Capital gain deduction percentage	60%
Capital gain deduction claimed by petitioners	<u>\$ 165,847.91</u>

Law and Analysis

For taxable year 1999, Idaho Code section 63-3022H stated:

63-3022H. Deduction of capital gains. (1) If an individual taxpayer reports a net capital gain in determining taxable income, sixty percent (60%) of the net capital gain from the sale or exchange of qualified property shall be a deduction in determining taxable income.

(2) The deduction provided in this section is limited to the amount of the net capital gain from all property included in federal taxable income. Net capital gains treated as ordinary income by the internal revenue code do not qualify for the deduction allowed in this section. The deduction otherwise allowable under this section shall be reduced by the amount of any federal capital gains deduction relating to such property, but not below zero.

(3) As used in this section "qualified property" means the following property having an Idaho situs at the time of sale:

- (a) Real property held at least eighteen (18) months;
- (b) Tangible personal property used in Idaho for at least twelve (12) months by a revenue-producing enterprise;
- (c) Cattle or horses held for breeding, draft, dairy or sporting purposes for at least twenty-four (24) months if more than one-half (1/2) of the taxpayer's gross income (as defined in section 61(a) of the internal revenue code) for the taxable year is from farming or ranching operations in Idaho;
- (d) Breeding livestock other than cattle or horses held at least twelve (12) months if more than one-half (1/2) of the taxpayer's gross income (as defined in section 61(a) of the internal revenue code) for the taxable year is from farming or ranching operations in Idaho;
- (e) Timber grown in Idaho and held at least twenty-four (24) months;
- (f) In determining the period for which property subject to this section has been held by a taxpayer, the provisions of section 1223 of the internal revenue code shall apply, except that when the holding period includes any period during which the taxpayer held property other than the property sold, all property held during the holding period must qualify under this section.

(4) If an individual reports a capital gain from qualified property from an S corporation or a partnership, a deduction shall be allowed under this section only to the extent the individual held his interest in the income of the S corporation or the partnership for the time required by subsection (3) of this section for the property sold.

(5) If an individual reports a capital gain from an estate, no deduction shall be allowed under this section unless the holding period required in subsection (3) of this section was satisfied by the decedent, the estate, or the beneficiary, or a combination thereof.

(6) If an individual reports a capital gain from a trust, no deduction shall be allowed under this section unless the holding period required in subsection (3) of this section was satisfied by the grantor, the trust, or the beneficiary, or a combination thereof.

(7) As used in this section "revenue-producing enterprise" means:

- (a) The production, assembly, fabrication, manufacture, or processing of any agricultural, mineral or manufactured product;
- (b) The storage, warehousing, distribution, or sale at wholesale of any products of agriculture, mining or manufacturing;
- (c) The feeding of livestock at a feedlot;
- (d) The operation of laboratories or other facilities for scientific, agricultural, animal husbandry, or industrial research, development, or testing.

- **Gain On Sale Of Florida Real Property**

The petitioners' argue, in their protest letter dated February 22, 2002, that:

1) The real estate sold in Florida. The intent of the Idaho Tax Law is to tax income earned outside of Idaho at the Idaho tax rate if no tax is paid in the state in which it is earned. This is implied in the P8 instructions for line 40, income taxes paid to other states. Florida has no state income tax so that no state tax was paid in Florida. If the capital gain deduction is not allowed, then income earned outside of Idaho would be taxed at a higher rate (much higher) than income earned in Idaho. This would be quite unfair.

In fact, the instruction on P 6 of the 1999 Idaho instructions states that qualified Idaho property is

- a) Real property held for at least 18 months.

This makes it clear that the intent is to tax profits at the Idaho rate, not higher. Since the Florida property is real property that was held for several years, [Redacted] This meets the requirement for the capital gains deduction.

In a subsequent letter dated April 29, 2002, the petitioners further state that:

We sold property in Florida, a state which has no state income tax. So we should pay no Florida State Income Tax.

Since we were Idaho residents, Idaho wants us to pay tax on the out-of-state profits at the Idaho State tax rate. We have already paid this in our 1999 Idaho state tax return.

But this judgment would tax us at two and one half (2½) times the Idaho rate just because the money was made outside of Idaho. This is the worst of both worlds, 1) having to pay state tax on money made in a state with no state income tax and 2) having to pay 2.5 times the rate than if the money were made in Idaho. The intent of the law is to tax us at the Idaho rate, not 2.5 times it.

The tax instructions state that an "Idaho property" is entitled to the capital gains deduction. It does not define an Idaho property as one with a "situs" in

Idaho. Because the intent of the law is to tax money Idaho residents make at the Idaho rate, an Idaho property must mean one that Idaho wants to tax.

Therefore, I should be allowed the capital gains deduction.

Idaho Code section 63-3022H(3) specifically limits property qualifying for the Idaho capital gains deduction to property “having an *Idaho situs* at the time of sale” (emphasis added). The petitioners have admitted that the property sold was Florida real property not Idaho real property. Therefore, the Tax Commission finds that the petitioners are not entitled to claim the Idaho capital gains deduction on gain from the sale of Florida real property.

- **Gain On The Sale Of Goodwill Relating To An Idaho Gift Shop**

The petitioners’ argue, in their protest letter dated February 22, 2002, that:

Perhaps I made a mistake in assuming that the sale of our store fell into the category of property used in a revenue-producing enterprise. Is the revenue producing property limited to the 4 items specified in item b of the instructions or is it any revenue producing enterprise? It certainly seems that the profit one makes on a business owned for 25 years should be considered a capital gain and fit into this category.

Idaho Code section 63-3022H limits the Idaho capital gains deduction to gain on certain types of “qualified property.” Idaho Code section 63-3022H(3) states:

(3) As used in this section "qualified property" means the following property having an Idaho situs at the time of sale:

- (a) Real property held at least eighteen (18) months;
- (b) Tangible personal property used in Idaho for at least twelve (12) months by a revenue-producing enterprise;
- (c) Cattle or horses held for breeding, draft, dairy or sporting purposes for at least twenty-four (24) months if more than one-half (1/2) of the taxpayer's gross income (as defined in section 61(a) of the internal revenue code) for the taxable year is from farming or ranching operations in Idaho;
- (d) Breeding livestock other than cattle or horses held at least twelve (12) months if more than one-half (1/2) of the taxpayer's gross income (as defined in section 61(a) of the internal revenue code) for the taxable year is from farming or ranching operations in Idaho;
- (e) Timber grown in Idaho and held at least twenty-four (24) months;

Capital gain on the sale of an intangible such as goodwill does not fall within the statute's definition of "qualified property."

Even if the petitioners had reported a capital gain on the sale of tangible personal property as a result of the sale of their Idaho gift shop, the Idaho gift shop does not fall within the statute's definition of a "revenue-producing enterprise." Idaho Code section 63-3022H((7)) states:

- (7) As used in this section "revenue-producing enterprise" means:
- (a) The production, assembly, fabrication, manufacture, or processing of any agricultural, mineral or manufactured product;
 - (b) The storage, warehousing, distribution, or sale at wholesale of any products of agriculture, mining or manufacturing;
 - (c) The feeding of livestock at a feedlot;
 - (d) The operation of laboratories or other facilities for scientific, agricultural, animal husbandry, or industrial research, development, or testing.

Accordingly, the Tax Commission finds that the petitioners are not entitled to the Idaho capital gains deduction on the gain from the sale of goodwill.

WHEREFORE, the Notice of Deficiency Determination dated January 25, 2002, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax and interest (calculated through September 30, 2002):

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
1999	\$13,602	\$2,576	\$16,178

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioners' rights to appeal this decision is enclosed with this decision.

DATED this ____ day of _____, 2002.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2002, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No. [Redacted]

ADMINISTRATIVE ASSISTANT 1